TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1934

No. 176

WILLIAM E. HERRING, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

No. 177

EULA DAY HERRING, PETITIONER,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT.

PETITION FOR CERTIORARI FILED JULY 14, 1934.

CERTIORARI GRANTED OCTOBER 8, 1934

SUPREME COURT OF THE UNITED STATES

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JOINT STIPULATION AND ORDER TO PRINT THE RECORD IN THE CASE No. 7214, AND TO OMIT THE PRINTING OF THE RECORD IN CASE No. 7215, ETC.

Filed November 8, 1933.

UNITED STATES CIRCUIT COURT OF APPEALS
FIFTH CIRCUIT.

WILLIAM E. HERRING,

Petitioner,

versus No. 7214

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

EULA DAY HERRING,

Petitioner,

versus No. 7215

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

It is ordered that the record in case No. 7214, William E. Herring, petitioner, vs. Commissioner of Internal Revenue, respondent, be printed, but that the printing of the record in case No. 7215, Eula Day Herring, petitioner, vs. Commissioner of Internal Revenue, respondent, be omitted; that a like judgment be entered in case No. 7215, Eula Day Herring, petitioner, vs. Commissioner of Internal Revenue, respondent, as in case No. 7214, William E. Herring, petitioner, vs. Commissioner of Internal Revenue, respondent.

N. P. BRYAN,
U. S. Circuit Judge.

Nov. 8, 1933.

1a

STIPULATION.

United States Circuit Court of Appeals for the Fifth Circuit.

Eula Day Herring, Petitioner,

v. Docket No. 7215

Commissioner of Internal Revenue, Respondent.

Whereas the issues in the above entitled cause are precisely the same as the issues in the action entitled William E. Herring v. Commissioner of Internal Revenue, and as the proceedings were consolidated, heard, and disposed of before the United States Board of Tax Appeals on one record, and as the transcript of record on the petitions for review are the same, except as to names, no useful purpose could be served by hearing the cases separately before this Honorable Court.

It is therefore stipulated and agreed by and between the parties in the above entitled cause, through their respective attorneys, that the printing of the transcript record in this cause may be dispensed with and that the decision of the Court in the case of William E. Herring v. Commissioner of Internal Revenue will control and will be accepted by the parties as the decision in the above entitled case.

ROBERT ASH,
Attorney for Petitioner.
E. BARRETT PRETTYMAN,
General Counsel, Bureau of Internal Revenue.

1t DOCKET No. 47041.

William E. Herring, Petitioner,
vs.
Commissioner of Internal Revenue, Respondent.

Appearances:
For Petitioner: Robert Ash, Esq., T. J. Reilly, Esq.
For Respondent: F. B. Schlosser, Esq., E. G. Sievers, Esq.

Docket Entries.

Transferred to Mr. Goodrich, 5/11/33.

1930
Jan. 17—Petition received and filed. Taxpayer notified. (Fee paid.)
Jan. 18—Copy of petition served on General Counsel.
Feb. 24—Notice of appearance of Robert Ash and T. J. Reilly as counsel for taxpayer filed.
Feb. 27—Answer filed by General Counsel.
Mar. 10—Copy served on taxpayer—General Calendar.
1931
Jan. 31—Motion to consolidate with docket 47042 filed by taxpayer. 2/3/31 granted.
Jan. 31—Motion to place on Texas Circuit Calendar filed by taxpayer. 2/3/31 granted.
1932
Feb. 4—Hearing set Apr. 6, 1932.
Feb. 9—Notice to disregard notice of hearing for April 6, 1932—case to remain on Circuit Calendar.
Oct. 28—Notice of hearing at Dallas, Texas, beginning Nov. 28, 1932.

Dec. 9—Hearing had before Mr. Lansdon, Division 8. Submitted on merits. Called from calendar of Nov. 28, 1932. Stipulation of facts filed. Briefs due Feb. 8, 1933.

1933

Jan. 9—Transcript of hearing 12/9/32 filed.

Feb. 2—Motion for extension to March 1, 1933 to file brief filed by taxpayer. 2/2/33 granted to 3/1/33 to both parties.

Mar. 4—Motion for extension to Feb. 15, 1933 to file brief filed by General Counsel.

Mar. 1—Brief filed by taxpayer.

Mar. 1—Brief filed by General Counsel.

June 29—Memorandum opinion rendered—Edgar J. Goodrich, Division 11. Judgment will be entered for the respondent.

July 5—Decision entered—Edgar J. Goodrich, Division 11.

Sept. 28—Petition for review by U. S. Circuit Court of Appeals, 5th Circuit, with assignments of error filed by taxpayer.

Sept. 28—Proof of service filed by taxpayer.

Sept. 28—Praecipe filed by taxpayer.

Sept. 28—Proof of service filed.

1933

2 Oct. 10—Agreed statement of evidence lodged.

Oct. 11—Stipulation re exhibits filed.

Oct. 11—Agreed statement of evidence approved and ordered filed.

Oct. 11—Order that original exhibits, petitioner's Nos. 2, 3 and 4, be transmitted to U. S. Circuit Court of Appeals, 5th Circuit, said exhibits to be returned to Board after they have served their purpose, entered.

3

PETITION.

Filed Jan. 17, 1930.

U. S. Board of Tax Appeals.

United States Board of Tax Appeals.

William E. Herring, Petitioner,
vs. Docket No. 47041
Commissioner of Internal Revenue, Respondent.

The above named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:AR:B-8-AMK-60D) dated November 26, 1929, and as a basis of this proceeding alleges as follows:

1. The petitioner is an individual residing at 411 Polk Street, Amarillo, Texas. Petitioner is the husband of Eula Day Herring and for the year 1926 filed his income tax return on a community property basis.

2. The notice of deficiency, a copy of which is attached and made a part of this petition, is dated November 26, 1929. The petitioner has no knowledge as to the date it was mailed.

3. The taxes in controversy are income taxes for the calendar year 1926 in the amount of $11,337.29.

4

4. The determination of tax set forth in the said notice of deficiency is based upon the following error:

(a) The Commissioner erred in refusing to allow a depletion deduction in the amount of $188,043.28 to the partnership of C. T. Herring & Son, of which petitioner has a one-half interest.

5. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a) C. T. Herring and the petitioner were equal partners in C. T. Herring & Son. The said partnership owned certain land in Texas, on all sides of which were producing oil and gas wells. In 1926 the Gulf Production Company, Roxana Petroleum Corporation, Magnolia Petroleum Company, Marland Oil Company, The Texas Company, and other large producers of oil and gas entered into certain leases or contracts with the said partnership whereby the partnership granted and conveyed to the said oil and gas producers the right to explore for and extract oil and gas from certain of the land owned by the partnership. In consideration of executing the said leases or contracts the partnership received $683,793.75 during the year 1926. In reporting the tax liability on the said $683,793.75 the partnership deducted $188,043.28 as depletion in accordance with the provisions of Section 204(c) of the Revenue Act of 1926 which provides:

"The basis upon which depletion, exhaustion, wear and tear and obsolescence are to be allowed in respect of any property shall be the same as is provided in sub-divisions (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that—

* * * * * * * *

"(2) In the case of oil and gas wells, the allowance for depletion shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) on the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph."

The respondent disallowed the said deduction.

Wherefore, the petitioner prays that this Board may hear the proceeding and

(a) Determine the proper method of taxing the $683,793.75 received by the partnership of C. T. Herring & Son in consideration of executing oil and gas leases on land owned by the partnership.

(b) Grant such other and further relief as the Board may deem proper.

ROBERT ASH,
THOMAS J. REILLY,
Attorneys for Petitioner,
Munsey Building, Washington, D. C.
PARFET & MARTLEW,
Wichita Falls, Texas,
Of Counsel.

6 State of Texas,
County of Potter, ss:

William E. Herring, being duly sworn, says that he is the petitioner named in the foregoing petition, that he has read the foregoing petition or had the same read to him, and is familiar with the statements contained therein, and that the facts stated are true, except as to those facts stated to be upon information and belief, and those facts he believes to be true.

WILLIAM E. HERRING.

Subscribed and sworn to before me this 10th day of January, 1930.

JOHN O. FAIN,
(Seal) Notary Public.

7 Treasury Department,
Washington.

IT:AR:B-8
AMK-60D

Nov. 26, 1929.

Mr. William E. Herring,
411 Polk Street,
Amarillo, Texas.

Sir:

In accordance with Section 274 of the Revenue Act of 1926, you are advised that the determination of your tax liability for the year 1926 discloses a deficiency of $11,337.29, as shown in the statement attached.

The section of the law above mentioned allows you to petition the United States Board of Tax Appeals within sixty days (not counting Sunday as the sixtieth day) from the date of the mailing of this letter for a redetermination of your tax liability.

However, if you do not desire to petition, you are raquested to execute the inclosed Form 866 and forward both original and duplicate to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7. The signing of this agreement form will expedite the closing of your return by permitting an early assessment of any deficiencies and preventing the accumulation of interest charges, since the interest period terminates thirty days after filing the agreement form, or on the date assessment is made, whichever is earlier; whereas if no agreement is filed, interest will accumulate to the date of assessment of the deficiencies.

Respectfully,
ROBT. H. LUCAS,
Commissioner,

By .....
Deputy Commissioner.

Inclosures:
Statement.
Form 866.
Form 882.
BAS-1

8 Statement.

IT:AR:B-8
AMK-60D

Nov. 26, 1929.

In re: Mr. William E. Herring,
411 Polk Street,
Amarillo, Texas.

Tax Liability.

Year	Corrected Tax Liability	Tax Previously Assessed	Deficiency
1926	$25,924.55	$14,587.26	$11,337.29

Further reference is made to the report of the Internal Revenue Agent in Charge at Dallas, Texas, covering the years 1923 to 1926, inclusive.

The years 1923, 1924 and 1925 have been closed on the basis set forth in office letter to you dated August 27, 1929, to which you have agreed.

You protested the disallowance of depletion to the partnership of C. T. Herring and Son amounting to $188,043.28 for the year 1926 and have indicated a desire to appeal this issue to the United States Board of Tax Appeals.

The depletion was disallowed in accordance with Income Tax Ruling 2361, Cumulative Bulletin VI-1, Page 73, for the reason that the property upon which depletion was claimed was neither proven nor producing during the year in question.

Net income reported	$187,190.66
Add:	
1. Partnership income	88,533.56
2. Rental income	1,677.16

3. Loss on sale of three houses overstated	650.00
4. Loss on the sale of three houses transferred	700.00
Net income adjusted	$278,751.38

9 Mr. William E. Herring. Statement.

One-half, community income	$139,375.69
Less:	
Exemption	1,750.00
Income subject to normal tax	$137,625.69

Computation of Tax.

Normal tax:		
1½% on $4,000.00		$ 60.00
3% on $4,000.00		120.00
5% on $129,625.69		6,481.28
Surtax on $139,375.69		19,535.14
Total tax		$ 26,196.42
Less:		
Earned income credit	$228.12	
Credit of 12½% of $350.00 (one-half of $700.00)	43.75	
		271.87
Net tax liability		$ 25,924.55
Tax previously assessed		14,587.36
Deficiency in tax		$ 11,337.29

Explanation of Items Changed.

1. Income from partnership of C. T. Herring and Son adjusted to agree with agent's report.

2. See Schedule 1-A, Item 5 of agent's report.

3. Loss on the sale of three houses sold off the lots upon which they were located overstated by $650.00.

4. Since these houses were held for more than two years, you have been allowed a credit of 12½% of $350.00, one-half of the corrected loss of $700.00, against the total tax liability in accordance with Article 1654 of Regulations 69.

Payment should not be made until a bill is received from the Collector of Internal Revenue for your district, and remittance should then be made to him.

10 Mr. William E. Herring. Statement.

A copy of this communication has been transmitted to your representative, Mr. Thomas J. Reilly, Munsey Building, Washington, D. C., who has on file in this office a duly recorded power of attorney.
FB-2

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11 ANSWER.

Filed Feb. 27, 1930.

(Title Omitted.)

The Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of In-

ternal Revenue, for answer to the petition of the above-named taxpayer, admits and denies as follows:

(1) Admits the allegations contained in paragraph 1 of the petition.

(2) Admits that the notice of deficiency, a copy of which is attached and made a part of the petition, is dated November 26, 1929, and avers that the said notice of deficiency was mailed to the petitioner on November 26, 1929.

(3) Admits the allegations contained in paragraph 3 of the petition.

(4) Denies the respondent erred in the determination of the deficiency as alleged in paragraph 4(a) of the petition.

(5) Admits that C. T. Herring and the petitioner were equal partners in C. T. Herring and Son; that the said partnership of C. T. Herring and Son deducted in its return for the year 1926 the sum of $186,043.28 as depletion, which amount was disallowed by the respondent. Denies all further allegations of fact contained in paragraph 5 of the petition.

Denies generally and specifically each and every allegation of the petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the appeal be denied.

(Signed) C. M. CHAREST,
General Counsel, Bureau of
Internal Revenue.

Of Counsel:

MAXWELL E. McDOWELL,
FRANK B. SCHLOSSER,
Special Attorneys, Bureau of
Internal Revenue.

12 MEMORANDUM OPINION.

William E. Herring, Petitioner,
v.
Commissioner of Internal Revenue, Respondent.

Mrs. Eula Day Herring, Petitioner,
v.
Commissioner of Internal Revenue, Respondent.

Docket Nos. 47041,
47042.

Robert Ash, Esq., for the petitioner.
F. B. Schlosser, Esq., and E. G. Sievers, Esq., for the respondent.

GOODRICH: In these proceedings, which were consolidated for hearing, petitioners assail respondent's determinations of deficiencies in income tax for the year 1926 against each of them in the amount of $11,337.29. Petitioners are husband and wife, residents of Texas, and filed separate returns under the Texas community property laws. They hold an interest in the partnership of C. T. Herring & Son, which was engaged in the cattle business, and owned several ranches in the vicinity of Amarillo. During 1926 the partnership granted a number of oil and gas leases to
13 various individuals and corporations and received as bonuses therefor a total of $683,793.75. No oil was produced from the properties during the taxable year; indeed, there was no production until 1930. The partnership, on its return for 1926, claimed as a deduction from its income, a depletion allowance of 27½ per centum of the total royalties received. Respondent has disallowed this claim and has restored the proportionate amounts of the sum so deducted to the incomes of the members of the partnership. That

action gives rise to the deficiencies herein, and the sole issue is whether the claim for the depletion allowance as a deduction should be allowed.

This issue is controlled by our decision in the case of Lizzie H. Glide, 27 B. T. A. #129, wherein we held that the allowance of a deduction on account of depletion of oil and gas wells was dependent upon production from the property. Here there was no production during the taxable year before us, nor was there at that time more than a speculative possibility of production.

In view of the cited decision, our conclusion here perforce must be contrary to petitioners' contentions. Cf. Aubrey Umsted et al. 28 B. T. A. #34.

Judgment will be entered for the respondent.

Enter:
Entered: June 29, 1933.

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14 DECISION.

United States Board of Tax Appeals,
Washington.

William E. Herring, Petitioner,
v. Docket No. 47041
Commissioner of Internal Revenue, Respondent.

Pursuant to the determination of the Board, as set forth in its report promulgated memorandum opinion entered June 29, 1933, it is

Ordered and decided: That there is a deficiency of $11,337.29 for the year 1926.

Enter:
Entered July 5, 1933.
(Signed) EDGAR J. GOODRICH,
(Seal) Member.

15 PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS.

Filed Sep. 28, 1933.

(Title Omitted.)

To the Honorable, the Judges of the United States Circuit Court of Appeals for the Fifth Circuit:

William E. Herring in support of this, his petition for the review of the decision of the United States Board of Tax Appeals entered July 5, 1933 approving a deficiency in income taxes for the year 1926 in the amount of $11,337.29 respectfully shows to this Honorable Court as follows:

I.

Statement of the Case.

On January 17, 1930 the petitioner filed with the United States Board of Tax Appeals, in pursuance with the Revenue Act of 1926, his petition requesting the redetermination of a deficiency in income taxes for the calendar year 1926 in the amount of $11,337.29. The petitioner contended that an allowance for depletion should be allowed on account of bonuses received for executing oil and gas leases.

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At the trial before the Honorable William C. Lansdon at Dallas, Texas, December 9, 1932 the following facts were stipulated or proved:

The petitioner and his wife filed separate income tax returns for 1926 under the Texas community property laws. They hold an interest in the partnership of C. T.

Herring and Son, Webster Building, Amarillo, Texas. The partners' respective shares in the partnership for 1926 were as follows:

C. T. Herring, Amarillo, Texas.....50%
William E. Herring, Amarillo, Texas....50%

The partnership's principal business in 1926 was cattle raising. It owns several ranches in the vicinity of Amarillo. During the taxable year, it leased portions of its ranches to various individuals and corporations for the purpose of exploring for and producing oil and gas. For executing the said leases, the partnership received bonuses totaling $683,793.75.

No oil development had been begun on any of the tracts at date of leasing. There was no oil well nearer than three and one-half miles at such date. There was no oil production during the taxable year.

Depletion in the amount of $188,043.28 against the above bonus receipts was claimed in the partnership return for the year 1926. This was at the
17 rate of 27½%. The respondent disallowed the deduction and increased the taxable income of the petitioners by their pro rata part of the deduction, to-wit: $94,021.64.

There was introduced in evidence a map (Pet.'s Ex. 2) showing in color the various leases referred to in the stipulation; a map (Pet.'s Ex. 3) showing the wells drilled on the Herring land and adjacent to it; and a geological contour map (Pet.'s Ex. 4) showing the trend of the Panhandle oil field in a northwesterly direction through Hutchinson County.

In the discovery of an oil pool certain fundamental factors must be present: (1) structural conditions must be favorable to the accumulation of oil, (2) oil must be in the vicinity, and (3) there must be a forced bed to act as a reservoir to hold the oil. In the Texas Panhandle such conditions exist as has been proved by

oil production throughout a territory of about 120 miles, starting at Wheeler County and running in a northwesterly direction through Moore County, including Wheeler, Gray, Carson and Hutchinson Counties. Over this space of approximately 120 miles conditions are generally the same. There is an enormous structural condition, underlaid with granite. The area is flat along the north side of this ridge. The oil accumulates to the north and east of the ridge and has migrated on up the structure until it comes against the granite.

18

The property here involved is in Hutchinson County. The geological condition referred to has resulted in production southeast of the Herring land and along the same direction northwest of the land. Reference to the geological map (Pet.'s Ex. 4) indicates that the Herring property is on the direct line of the favorable geological conditions. That map and Petitioner's Exhibit 3 show the 20,000,000 foot gas well to the north of the property; the numerous wells close to the property on the east, west and south, and the production some distance away to the northwest, all of which followed the general geological trend of the field.

Four wells have been drilled on the Herring property. The first, on the Bason Survey in the northernmost portion, is shown on the map (Pet.'s Ex. 3) as a dry hole, but the testimony shows it was drilled by the Gulf Production Company and made from two to three million feet of gas with a good showing of oil. The well drilled by the Gulf Production Company in Section 5 H. & G. N. Survey, in the southern portion of the tract, made 11,400,00 feet of gas and eight to ten barrels of oil. The Phillips Petroleum Company drilled a well in Section 7 of the H. & O. B. R. R. Co. survey on the east side of the property which produced four and one-half million feet of gas, with a favorable showing of oil. The Magnolia drilled a well, opposite

the Phillips well and a very short distance to
19 the south. The Magnolia well produced five
million feet of gas.

The wells mentioned were all drilled about 1930: the reason that they had not been drilled prior to that time being due to economic conditions. The Herring land was leased in long-term leases. It is the logical land to be drilled as soon as economic conditions improve. Under present conditions Panhandle oil cannot compete with oil produced nearer tidewater, because of cost of shipment and because of its high viscosity and sulphur content.

At the time of the hearing (December, 1932) the gas pipe lines from the Panhandle to Chicago, Omaha, Denver, Fort Worth and Indianapolis had been completed, so the gas wells on the Herring property could be commercially operated very profitably, the gas being worth about 4 cents a thousand cubic feet. At this rate the 23,900,000 feet of gas produced easily by the four wells mentioned above would sell for $956.00 a day with the royalty to the Herrings amounting to $119.50 per day.

The developments since 1926 have not in any way condemned the Herring land for oil production, "in fact, the developments we have there now would give us more information for drilling wells later on; I think it would be easier to locate production on that land than it would be without any wells drilled around there. We have wells practically on every side; we have production here to the east, production to the south
20 of us, production to the west of it and wells
of twenty to forty barrels on the north and northwest of it."

The wells drilled on the Herring land showed the same structural condition as is typical of the Panhandle field. Due to a re-entrant in the Herring land it is particularly well situated from a structural viewpoint, and it is very probable that oil will be found on the land.

It is possible, but not probable, that there might never be oil wells on this Herring land, because there is evidence that there is gas under the whole ranch, and from known indications, it looks very probable that there will be oil there. In the Panhandle the oil is found in pools, some very close together and in some places about seven miles apart, but the gas is continuous throughout the area. Gas and oil are very closely related. In the Panhandle area, but not in other oil pools, the oil is found floating on water at about sea level. Gas, being of lighter specific gravity, is found on top of the oil. The location of gas suggests the probability of finding oil. The Herring land is very favorably located geologically. Conditions as known in 1926 were no different from 1932, except that in 1926 the information was not as complete.

In 1926 the nearest oil production to the Herring land was three and one-half miles, and in 1932 one and one-half miles.

June 29, 1933 the Board of Tax Appeals
21 rendered a memorandum opinion approving the determination of the Commissioner that the petitioner was not entitled to depletion on the bonuses received for executing the oil and gas leases because no oil was produced from the properties in 1926. The said opinion was based on the Board's previous opinion in the case of Lizzie H. Glide 27 B. T. A. (July 5, 1933). The Board entered its decision in accordance with the said opinion.

II.

Designation of Court of Review.

The petitioner, being aggrieved by the said opinion and decision, desires a review thereof in accordance with Section 1002 (a) of the Revenue Act of 1926, by the United States Circuit Court of Appeals for the Fifth Circuit, whereof he is an inhabitant.

III.

Assignments of Error.

The petitioner as a basis for review, makes the following assignments of error:

1. The Board of Tax Appeals erred in holding that the bonuses received for executing oil and gas leases are not subject to an allowance for depletion under Section 204 (c) (2) of the Revenue Act of 1926.

2. The Board of Tax Appeals erred in holding that in 1926 there was not more than a speculative possibility of oil or gas production on the property
22 in question, which holding is not supported by any evidence.

Wherefor the petitioner prays that the decision of the Board of Tax Appeals entered against him be reversed and that the Court grant such other and further relief as the Court may deem meet and proper in the premises.

WM. E. HERRING,
Petitioner,
By ROBERT ASH,
Attorney for Petitioner,
Munsey Building, Washington, D. C.

District of Columbia, ss:

Robert Ash, being duly sworn, states that he is attorney for the petitioner; that he knows the contents of the foregoing petition; that to the best of his knowledge and belief the statements contained therein are true, and that the assignments of error are well taken.

ROBERT ASH.

Subscribed and sworn to before me this 28th day of September, 1933.

(Sgd.) MINNIE BURATTI BURCH,
Notary Public.

23 STATEMENT OF THE EVIDENCE.

Lodged Oct. 10, 1933.

Filed Oct. 11, 1933.

(Title Omitted.)

The above entitled cause came up for hearing before the Honorable W. C. Lansdon, Member of the United States Board of Tax Appeals at Dallas, Texas, on the 9th day of December, 1932, there being present the Petitioner by his counsel, Robert Ash and the Respondent by his counsel, Frank B. Schlosser.

Before the introduction of the testimony counsel agreed there was no dispute as to any figures and that the following stipulation of facts should be received in evidence:

The petitioners are husband and wife and filed separate returns under the Texas community property laws. They hold an interest in the partnership of C. T. Herring and Son, Webster Building, Amarillo, Texas. The partners' respective shares in the partnership for 1926 were as follows:

C. T. Herring, Amarillo, Texas.....50%
William E. Herring, Amarillo, Texas..50%

24 The partnership's principal business in 1926 was cattle raising. It owns several ranches in the vicinity of Amarillo. During the taxable year it leased portions of its ranches to various individuals and corporations for the purpose of exploring for and producing oil and gas. The various lessees and the bonus received by the partnership for each lease are as follows:

Sid Hedgecocke, Amarillo, Texas.....	$ 12,400.00
Elgin Boulware, Amarillo, Texas.....	6,400.00
R. B. Archer, Amarillo, Texas.....	9,200.00
Roxanna Petroleum Co., Amarillo, Texas..	66,864.00

Magnolia Petroleum Co., Amarillo, Texas..	36,067.75
McMann Oil and Gas Co., Amarillo, Texas.	30,040.00
Marland Oil and Gas Co., Amarillo, Texas..	17,808.00
Gulf Production Co., Amarillo, Texas.....	209,328.00
Empire Gas and Fuel Co., Amarillo, Texas.	20,580.00
Delmar Oil Co. and Osage Dev. Co., Amarillo, Texas	6,608.00
C. B. Johnson, Amarillo, Texas.....	5,490.00
J. Ray, Amarillo, Texas.....	8,000.00
J. E. Bryant, Amarillo, Texas.....	8,000.00
C. H. Clark, Amarillo, Texas.....	32,000.00
Midwest Exploration Co., Amarillo, Texas.	40,420.00
J. F. Forbes	6,400.00
Amerada Petroleum Co., Amarillo, Texas..	54,450.00
Texas Co., Amarillo, Texas.....	113,738.00
Total bonuses received, 1926.....	$683,793.75

No oil development had been begun on any of the tracts at date of leasing. There was no oil well nearer than three and one-half miles at such date. There was no oil production during the taxable year.

Depletion in the amount of $188,043.28 against the above bonus receipts was claimed in the partnership return for the year 1926. This was at the rate of 27½%. The respondent disallowed the deduction and increased the taxable income of the petitioners by their pro rata part of the deduction, to-wit: $94,021.64.

There was introduced in evidence, without objection as Petitioner's Exhibit No. 1, a copy of oil and gas lease which it was agreed was typical.

There was introduced in evidence, without objection as Petitioner's Exhibit No. 2, a map showing, in color, the various leases involved in the case.

25 Whereupon the petitioner, to maintain the issues in his behalf, introduced the following testimony:

LAWRENCE R. HAGY, being first duly sworn, testified that he was a geologist and oil and gas operator. He was educated in geology at the University of Oklahoma and since his graduation, has been continuously employed in the oil business. His first activity in the oil business was in southern Oklahoma and Texas. He is familiar with the oil situation in the Panhandle (R. 6), and has had knowledge of it for ten years. He knows property in the Panhandle and has made geological studies of the strata there. He has been familiar with it practically since the inception of the field.

In determining whether or not there is an oil field a geololist would consider three factors that are fundamental in the discovery of an oil pool. It is necessary to have favorable structural condition which would cause accumulation; there must be oil in the vicinity and there must be a forced bed to act as a reservoir to hold the oil. In the Panhandle these conditions exist. This is proved by the fact that they have production throughout a territory of about 120 miles running in a northwesterly direction, starting at Wheeler County and continuing through Moore County. Over this space of approximately 120 miles conditions are generally the same. There is a very enormous structural condition underlaid with granite; it starts in Wheeler County and extends in a northwesterly direction of 120

26 miles. The area is flat along the north side; in other words, the oil accumulates in the base to the north and east of this ridge and has migrated on up the structure until it comes against this granite. There is practically continuous production for forty or fifty miles through this area. (R. 7, 8). Referring to a map (Petitioner's Exhibit No. 3), the witness stated that production starts in Wheeler County and comes

through Wheeler, Gray and Carson Counties and Hutchinson County, where the Herring land is located. It continues in a northwesterly direction. Four wells were drilled on the Herring land, one in the northern part, one in the southern part and two in the east central part. As we go past the Herring land, there is production on the east side where there is a well that made 20,000,000 feet of gas and about twenty barrels of oil. On the Thomas Ross there is a well that made forty-three barrels of oil. There is considerable production in Moore County following the same trend of production. The Herring land lies very favorably to this enormous granite ridge the witness spoke of and the production is flanked up on the side of that. The land lies in a very favorable geological position (R. 8).

The witness is familiar with the four wells drilled on the Herring land. The Gulf well drilled on the Bason Survey, in the northern part of the ranch, made from two to three milion feet of gas with a favorable showing of oil; the well drilled in Section 5 H. and G. N. survey, by the Gulf Petroleum Company, made eleven million four hundred thousand feet of gas and about eight to ten barrels of oil. The well drilled by the Phillips Petroleum Company in Section 7 made four and a half million feet of gas, with a favorable showing of oil. The Magnolia drilled a well opposite that at a short distance, expecting it would have more favorable production conditions, and that well was completed as a five million foot gas well, with a small showing of oil. These wells have been drilled and give proof that the land is more favorably located than it was in the earlier days, because they have later information to go by and in the future wells will be drilled there due to those conditions. The four wells were drilled about 1930 (R. 9). One reason there has not been more drilling, is because of the economic conditions there. They are so far from the Gulf that the Panhandle oil is not worth as much as oil on the Gulf and

27

so they have practically stopped drilling in the Panhandle. They have only fourteen of fifteen wells drilling now while in 1929 they had sixty to one hundred.

The gas business in the Panhandle is just coming into its own. The big line to Chicago was completed last year; the line to Indianapolis was completed last year; they have an outlet for half a billion cubic feet of gas a day. Those lines have been completed and the gas is becoming more valuable all the time, and these gas wells would bring in a very nice return now, where they wouldn't have made a return in 1930. The average price of gas for this area is about four cents a thousand. The wells on the Herring property can be operated very profitably. Developments since 1926 have not in any way condemned the land for oil production. In fact the developments there now give us more information for drilling wells later on. The witness stated it would be easier to locate production on that land than it would have been without any wells drilled around there. There are wells on practically every side; (R. 10). There is production on the south, production to the east, production to the west and wells of twenty to forty barrels on the north and northwest of the land.

28

The wells drilled on the Herring land show the same structural conditions as are typical in the field. The wells are not what would be called good producers but from them the area can be picked out which will be productive. No doubt a number of wells will be developed.

Referring to a contour map (Pet.'s Ex. No. 4), reference was made to a big line from twenty-five to twenty-six hundred feet; the lines show that at one thousand feet above sea level there are wells. Most of the production in the Panhandle is encountered between the 800 foot and 1000 foot contours. The heavy line is the 1000 foot contour. Ninety per cent of the production lies between the 800 and 1000 foot contour. The map shows the production coming through Carson, Gray and

Hutchinson Counties right up to the ridge and
29 if they have the same conditions which exist on the ranch there is no doubt that production will be developed on the ranch. (R. 11, 12.)

It is probable that there may be production under the 800 foot and higher than the 1000 foot line but most of it is between those two. A re-entrant is the thing that caused the concentration of oil in the border pool. The contour map shows that the same condition exists on the Herring land and it is considered that it will tend to make that land more productive, more concentration of oil; it is very favorably situated geologically, from what is known of the Panhandle structural conditions.

From the witness' knowledge of the Herring land, it is very probable they will get oil on it. (R. 12.)

The Herring land was taken on long term leases and there was other oil in the Panhandle that was being developed; the Herring land was owned in large tracts and was not developed. Along in 1929 there was more or less of a depression in the Panhandle in the oil business and there has been very little development since. It is the area that will be prospected in the future as soon as economic conditions improve. The Panhandle oil can not compete with East Texas production because it has a sulphur content which is objectionable and it is very hard to handle particularly in winter because it has so much paraffin in it that it congeals. The production in East Texas, or close to Tidewater,
30 will be used before they go back to the Panhandle to drill more wells.

Without objection, there was introduced in evidence, as Petitioner's Exhibit No. 3, the map showing the oil production in the Panhandle (R. 13).

Without objection, there was introduced, as Petitioner's Exhibit No. 4, a contour map of the Panhandle.

The Panhandle facilities for disposing of gas consists of five completed major traffic lines, one to Denver, one to Chicago, one to Omaha, one to Indianapolis and one to Fort Worth that handle a tremendous amount of gas. The project has all been developed within the last two years, with the exception of the Denver line and the Wichita Falls line. The pipe lines are not considered common carriers and at the present time there is no way that the owner of a gas well can dispose of his gas. The last Legislature wrote an oil and gas law that will make it possible for pipe line companies to transport gas. At the present, pipe line companies own their own gas wells. (R. 14, 15.)

Plans are in existence for constructing other gas lines. River crossings, booster stations, the bases for pumps are so constructed that parallel lines can be laid. Due to financial conditions these lines have been
31 postponed. The Texhoma twenty-four inch line crosses the Herring land. R. 16.)

Upon cross examination the witness testified: He had kept up with practically all the developments in the territory and had examined the geological structure of the Herring property. He had been on the property numerous times but not for the last six months. He started a well immediately south of there in 1926. The well was not on the Herring property but immediately south of it. (R. 16.)

The first gas production in the Panhandle was brought in in 1918, the first oil well about 1922 or 1923. In 1923 a well was discovered about four and one-half miles south of the Herring land. In the same year a well was discovered three and a half miles east of there.

It is possible, but not probable, that there might never be any wells in the Herring property because they have evidence now that there is gas underneath the whole ranch and from what indication they have, it seems very probable that there will be oil there. The evidence was obtained in 1930 (R. 17.)

When there is more demand for oil, the Panhandle will have more production. The East Texas production might last seven years or it might last fifteen years according to the amount of oil taken out per day. The Panhandle production is a continuation of pools along the granite ridge. These pools are all found on the north side of the ridge. In some places the pools are very close together, within two or three miles
32 and in other places about seven miles.

On re-direct examination the witness stated: The gas is continuous throughout that area. (R. 18.) The Panhandle gas, which is of light specific gravity, is on top of the oil and the water is below that. Gas is on top of the Panhandle structure and the oil on the north flank of this structure. The location of gas indicates to a geologist the probability of oil as the two are closely related.

In the Panhandle area production is of a uniform depth, about 100 feet above sea level. The oil is floating on the water which is about at sea level. This is true of the entire Panhandle area, but is not common in other oil pools. The Herring land is north of the granite ridge referred to and is very favorably located. (R. 19.)

In 1926 they had an idea that this general structural condition is like it is today but they did not have the complete information that they have today. The nearest oil production to the Herring land is about a mile and a half due east. In 1926 the nearest production was about three and a half miles.

Upon re-cross examination the witness stated that the discovery of gas is not always followed by the discovery of oil. In the Panhandle oil and gas deposits are found in the lower permean formation (R. 20).

R. S. POWELL, being duly sworn, stated that he resided in Wichita Falls, Texas and was Division Geologist for the Texas Company. He was educated
33 in geology in the Colorado School of Mines and was familiar with the Herring land in the Panhandle. His company had leases there. It has not drilled on the leases yet, but is paying rentals. In 1926, when the company got the lease, they paid a bonus (R. 21).

There were geological indications that oil might be discovered on the land which was the reason that the Texas Company bought the lease. They haven't drilled the land because it is their practice in the Panhandle, due to the large amount of acreage they own in the area, to drill only the acreage which they have to drill. In fact, to keep in line with their economic program, all they drill is offsets; offsets created by the drilling of others keep them busy, and they have not had time and have not had to drill the other.

Upon cross examination Mr. Powell stated that he went with the Texas Company on January 15, 1926 as a geologist. He had never been on the Herring land. He knew about the geology of the Herring land because he figured it out himself from well logs made by drillers. He was never on the property in 1926 (R. 22).

Upon re-direct examination the witness stated that it was not necessary to go on a particular piece of property to know the geology of it. The Texas Company's field men can supply a geologist with sufficient information. Geology today is usually worked by sub-sur-
34 face, in which no surface indications have any relation and that is especially true in the Panhandle. (R. 23.)

The parties certify that the foregoing contains the substance of all the evidence given on the hearing of this proceeding.

ROBERT ASH,
Attorney for Petitioner,
Munsey Building,
Washington, D. C.
E. BARRETT PRETTYMAN,
General Counsel, Bureau of Internal Revenue, Attorney for Respondent.

The statement of the evidence is approved and ordered to be made of record in the above entitled cause this 11th day of Oct., 1933.

(s) EDGAR J. GOODRICH,
Member.

35 EXHIBIT #1.

Form 88—(Prod ers)—Texas.

Oil and Gas Lease.

Agreement, made and entered into 8th day of May, 1926, by and between W. E. Herring, party of the first part, hereinafter called lessor (whether one or more) and Roxana Petroleum Corporation, party of the second part, hereinafter called lessee.

Witnesseth, that the said lessor, for and in consideration of Twenty Dollars and other cash, Dollars cash in hand paid, receipt of which is hereby acknowledged and of the covenants and agreements hereinafter contained on the part of lessee to be paid, kept and performed, has granted, demised, leased and let and by these presents does grant, demise, lease and let unto the said lessee,

for the sole and only purpose of mining and operating for oil and gas, and laying pipe lines, and building tanks, powers, stations and structures thereon to produce, save and take care of said products, all that certain tract of land situate in the County of Hutchinson, State of Texas, described as follows, to-wit: The East one-half of the Southeast Quarter (E½ SE¼), of Section 5, Block "J" H&GN R. R. Co. Survey, and containing eighty (80) acres, more or less.

It is agreed that this lease shall remain in force for a term of five years from date, and as long thereafter as oil or gas, or either of them, is produced from said land by the lessee, and or if lessee shall commence drilling operations at any time while this lease is in force this lease shall remain in force and its terms shall continue so long as such operations continue with due diligence and if production results therefrom then as long as production continues.

In consideration of the premises the said lessee covenants and agrees:

1st. To deliver to the credit of lessor, free of cost, in the pipe line to which lessee may connect his wells, the equal one-eighth part of all oil produced and saved from the leased premises.

2nd. To pay the lessor one-eighth, at the market price for the gas so used, for the gas from each well where gas only is found, while the same is being used off the premises, and lessor to have gas free of cost from any such well for all stoves and all inside lights in the principal dwelling house on said land during the same time by making his own connections with the wells at his own risk and expense.

3rd. To pay lessor for gas produced from any oil well and used off the premises or for the manufacture of casing head gas, one-eighth, at the market price for

the gas so used, for the time during which such gas shall be used, said payments to be made quarterly.

If no well be commenced on said land on or before the 8th day of May, 1927, this lease shall terminate as to both parties, unless the lessee on or before that date shall pay or tender to the lessor or to the lessor's credit in the Herring National Bank at Vernon, Texas, or its successors, which shall continue as the depository regardless of changes in the ownership of said land, the sum of Eighty & 00/100 Dollars, which shall operate as a rental and cover the privilege of deferring the commencement of a well for 12 months from said date. In like manner and upon like payments or tenders the commencement of a well may be further deferred for like periods of the same number of months successively. And it is understood and agreed that the consideration first recited herein, the down payment, covers not only the privileges granted to the date when said first rental is payable as aforesaid, but also the lessee's option of extending that period as aforesaid and any and all other rights conferred.

Should the first well drilled on the above described land be a dry hole, then, and in that event, if a second well is not commenced on said land within twelve months from the expiration of the last rental period which rental has been paid, this lease shall terminate as to both parties, unless the lessee on or before the expiration of said twelve months shall resume the payment of rentals in the same amount and in the same manner as hereinbefore provided. And it is agreed that upon the resumption of the payment of rentals, as above provided, that the last preceding paragraph hereof, governing the payment of rentals and the effect thereof, shall continue in force just as though there had been no interruption in the rental payments.

If said lessor owns a less interest in the above described land than the entire and undivided fee simple

estate therein, then the royalties and rentals herein provided shall be paid the lessor only in proportion which his interest bears to the whole and undivided fee.

Lessee shall have the right to use, free of cost, gas, oil and water produced on said land for its operation thereon, except water from wells of lessor.

When requested by the lessor, lessee shall bury its pipe lines below plow depth.

No well shall be drilled nearer than 200 feet to the house or barn now on said premises, without the written consent of the lessor.

Lessee shall pay for damages caused by its operations to growing crops on said land.

Lessee shall have the right at any time to remove all machinery and fixtures placed on said premises, including the right to draw and remove casing.

If the estate of either party hereto is assigned, and the privilege of assigning in whole or in part is expressly allowed, the covenants hereof shall extend to their heirs, executors, administrators, successors or assigns, but no change in the ownership of the land or assignment of rentals or royalties shall be binding on the lessee until after the lessee has been furnished with a written transfer or assignment or a true copy thereof; and it is hereby agreed in the event this lease shall be assigned as to a part or parts of the above described lands and the assignee or assignees of such part or parts shall fail or make default in the payment of the proportionate part of the rents due from him or them, such default shall not operate to defeat or affect this lease in so far as it covers a part or parts of said lands which the said lessee or any assignee thereof shall make due payment of said rental.

Lessor hereby warrants and agrees to defend the title to the lands herein described, and agrees that the lessee shall have the right at any time to redeem for lessor, by payment, any mortgage, tax or other liens on the

above described lands, in the event of default of payment by lessor, and be subrogated to the rights of the holder thereof, and lessor hereby agrees that any such payment made by the lessee for the lessor shall be deducted from any amounts of money which may become due the lessor under the terms of this lease.

Lessor hereby waives all statutory claims to the above described lands as his homestead, his homestead being in Amarillo, Potter County, Texas.

In testimony whereof, we sign, this the 8th day of May, 1926.

W. E. HERRING. (Seal)
..... (Seal)
..... (Seal)

Witness:

.....
.....

(Copy.)

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36 DESIGNATION OF RECORD.

Filed Sep. 28, 1933.

William E. Herring, Petitioner,

vs. Docket No. 47041

Commissioner of Internal Revenue, Respondent.

United States Board of Tax Appeals.

To the Clerk of the United States Board of Tax Appeals:

Will you please prepare and transmit to the Clerk of the United States Circuit Court of Appeals for the Fifth Circuit certified copies of the following documents in the above entitled case:

1. Docket entries of proceedings before the United States Board of Tax Appeals.

2. Petition.

3. Answer.

4. Memorandum Opinion of the Board.

5. Decision (Order of redetermination) of Board.

6. Petitioner's Exhibit No. 1 (Specimen lease).

7. Petitioner's Exhibit No. 2 (Map showing leases).

8. Petitioner's Exhibit No. 3 (Map showing production in Panhandle field).

9. Petitioner's Exhibit No. 4 (Contour map showing geological structure.)

10. Statement of the evidence as settled or agreed upon.

37 11. Petition for review.

12. This designation of record.

The foregoing to be prepared, certified and transmitted as required by law and the rules of the United States Circuit Court of Apeals for the Fifth Circuit.

ROBERT ASH,
Attorney for Petitioner,
Munsey Building,
Washington, D. C.

38 CERTIFICATE.

(Title Omitted.)

I, B. D. GAMBLE, clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages, 1 to 37, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 19th day of Oct., 1933.

B. D. GAMBLE,
Clerk, United States Board of
(Seal) Tax Appeals.

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39 ORDER.

(Title Omitted.)

It appearing that it is proper and necessary that certain exhibits be transmitted to the United States Circuit Court of Appeals, Fifth Circuit, as physical exhibits for inspection by the said Court, and in accordance with stipulation of the parties pursuant to Rule 34 of the Court, it is

Ordered that Petitioner's Exhibits 2, 3 and 4 be transmitted to the United States Circuit Court of Appeals, Fifth Circuit, in connection with petition for review of the above proceeding, said Exhibits to be returned to the Board after they have served their purpose in the Court.

(Signed) EDGAR J. GOODRICH,
(Seal) Member.

Dated Washington, D. C.,
Oct. 11, 1933.

[fol. 37] That thereafter the following proceedings were had in said cause in the United States Circuit Court of Appeals for the Fifth Circuit, viz:

No. 7214

WILLIAM E. HERRING

versus

COMMISSIONER OF INTERNAL REVENUE

ARGUMENT AND SUBMISSION

Extract from the Minutes of March 7th, 1934

On this day this cause was called, and after argument by Robert Ash, Esq., for petitioner, and Milford S. Zimmerman, Esq., Special Assistant to the Attorney General, for respondent, was submitted to the Court.

[fol. 38] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 7214

WILLIAM E. HERRING, Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent

Petition for Review of Decision of U. S. Board of Tax Appeals (District of Texas)

Before Bryan, Sibley and Walker, Circuit Judges

OPINION OF THE COURT AND DISSENTING OPINION OF SIBLEY, CIRCUIT JUDGE—Filed April 24, 1934

WALKER, Circuit Judge:

During the year 1926 the Petitioner and his wife each owned a 50% interest in the partnership of C. T. Herring & Son, and they filed separate income tax returns for that

year under the community property laws of the State of Texas. In 1926 the partnership owned several ranches in the vicinity of Amarillo, Texas, and its principal business was cattle raising. During that year it leased, for a period of five years, portions of its ranches to sundry individuals and corporations "for the sole and only purpose [fol. 39] of mining and operating for oil and gas, and laying pipe lines, and building tanks, power stations and structures thereon to produce, save and take care of said products." Under those leases the partnership received as cash bonuses therefor a total of $683,793.75. No oil development had been begun on any of the leased land at the dates of the leases, and at those dates there was no oil well within 3½ miles of the leased land. During the year1926 there was no oil production on the leased land. No wells were sunk on the leased land until the year 1930, during which four wells were sunk, with the result that gas and oil were produced. In the partnership return for the year 1926 a depletion deduction was taken in the amount of $18,043.28, being 27½ per cent of the total amount of bonus receipts. In his income tax return for that year the Petitioner deducted from the amount of his gross income one-half of the amount of the above mentioned deduction taken in the partnership return. This deduction was disallowed by the Respondent, with the result that Petitioner's distributive share of the partnership net income was increased, and a deficiency of $11,337.29 was determined. The Board of Tax Appeals sustained that action of the Respondent. The action of that tribunal is complained of by petition for review.

The question presented is whether the Petitioner was entitled to deduct from his 1926 gross income the whole or a part of the amount of the deduction claimed by him on account of depletion. The following are the governing statutory provisions: "In computing net income there shall be allowed as deductions: * * * A reasonable allowance for the exhaustion * * * of property used in the trade or business. * * * In the case of mines, oil and gas wells, and other mineral deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in [fol. 40] each case," etc. § 214 (a) (9) Revenue Act of 1926, 44 Stat. 26, 26 U. S. C. A. § 955 (a) (9): "Sec. 204.

(c). The basis upon which depletion, exhaustion, wear and tear, and obsolescence are to be allowed in respect of any property shall be the same as is provided in subdivision (a) or (b) for the purpose of determining the gain or loss upon the sale or other disposition of such property, except that— * * *

(2) In the case of oil and gas wells the allowance for depreciation shall be 27½ per centum of the gross income from the property during the taxable year. Such allowance shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property, except that in no case shall the depletion allowance be less than it would be if computed without reference to this paragraph." Revenue Act of 1926, 44 Stat. 9, 26 U. S. C. A. § 935.

For support of the contention of the Petitioner much reliance is placed on the decision in the case of Murphy Oil Co. v. Burnet, 287 U. S. 299, to the effect that where the execution of an oil and gas lease is followed by the production of oil a depletion allowance must be made in respect to a bonus paid to the lessor. The report of that decision contains no statement as to whether oil was or was not extracted from the leased land during the taxable years in question, 1919 and 1920. But from the report of the decision which was affirmed in that case it appears that the leased land produced oil in each of those years. Murphy Oil Co. v. Burnet, 55 Fed. (2), 17. The court which rendered the decision which was affirmed by the Supreme Court expressly ruled that the depletion allowable to the lessor in an oil lease was limited to actual depletion during the taxable years in question. The decision of the Supreme Court in that case does not support a contention that a deduction for depletion with respect to a bonus payment is allowable to a taxpayer who, during the taxable year in question, received that bonus upon his executing an oil and gas lease covering land [fol. 41] which during that year contained no oil or gas well, but in which several years later were sunk wells which produced oil and gas. We think it cannot reasonably be said that the provision allowing, "in the case of * * * oil and gas wells", a deduction from gross income for depletion discloses an intention to authorize the allowance of such a deduction from a taxpayer's gross

income in a year in which he had no interest in any then existing oil or gas well, but during which he received a bonus upon his execution of an oil and gas lease covering land which had never been explored for oil or gas by sinking a well or starting to sink one, but in which several years later were sunk wells which produced oil or gas. The deductions from gross income authorized by an above cited statute are based upon happenings or facts existing during the taxable year in question which are regarded as having the effect of offsetting to some extent the taxpayer's gains or profits realized or accrued during that year, and may involve some return of the taxpayer's capital investment. In the case of Lynch v. Alworth-Stephens Co., 267 U. S. 364, the court construed and applied the provisions of the Income Tax Law of September 6, 1916, as to deductions based on exhaustion or depletion of mines. The following are extracts from the opinion in that case: "In the case of mines, a specific kind of property, the exhaustion is described as depletion, and is limited to an amount not exceeding the market value in the mine of the product mined and sold during the year. The interest of respondent in the mines being property, its right to deduct a reasonable allowance for exhaustion of such property, if there be any, during the taxable year results from the plain terms of the statute, such deduction, since the property is an interest in mines, to be limited to the amount of the exhaustion of respondent's interest caused by the depletion of the mines during the taxable year. We agree with the Circuit Court of Appeals, 294 Fed. 194, that, [fol. 42] 'The plain, clear and reasonable meaning of the statute seems to be that the reasonable allowance for depletion in case of a mine is to be made to every one whose property right and interest therein has been depleted by the extraction and disposition of the product thereof which has been mined and sold during the year for which the return and computation are made.' * * * The deduction for depletion in the case of mines is a special application of the general rule of the statute allowing a deduction for exhaustion of property." As to the measurement or determination of the amount of allowable depletion deduction the statute applicable in the instant case is different from the one which was construed and applied in the cited case. But the statute applicable in thei instant

case, we think not less clearly than the one which was construed and applied in the cited case, discloses a legislative intention to allow a deduction for depletion only when depletion occurs during the taxable year in question. In the case of Burnet v. Thompson Oil & G. Co., 283 U. S. 301, a taxpayer claimed that it was entitled to a deduction from gross-income for depletion which would represent not only that year's sustained depletion, but make up for sustained but disallowed depletion in earlier years. In rejecting that claim the court said: "The tax is an income tax for 1918, and in the absence of express provision to the contrary, it is not to be supposed that the taxpayer is authorized to deduct from that year's income, depreciation, depletion, business losses or other similar items attributable to other years. The very fact that Congress denied deductions equal to the sustained depletion in the earlier years negatives an intent that they should be allowed in later years, as if for depletion then sustained. The construction adopted by the court below in effect results in including in the taxable year items referable to other years, and is contrary to the theory of a tax for specific years.

The nature of the tax as one for annual periods has been [fol. 43] repeatedly mentioned in dealing with its application in various situations. The taxable year 1918, and that only, is involved, and deductions applicable to that year only should be allowed."

Petitioner claimed that in the computation of his income tax liability for the year 1926 he was entitled to a depletion deduction from his gross income with respect to the amount of bonuses he received in that year, though in that year there was no depletion or reduction of the oil or gas in place in the land covered by the leases on which the bonus payments were made. It was suggested in argument that, by reason of Petitioner's receipt in that year of the large sum in bonuses, depletion allowances made in that year probably would be more beneficial to Petitioner than such allowances made in later years were likely to be. It was not claimed that the applicable statute providing for depletion allowances "in the case of oil and gas wells", or any Regulation under that statute, contains anything indicating an intention to change the rule that a depletion reduction from gross income in a taxable year in question must be based on depletion which occurred in that year.

We summarize: Petitioner claimed in effect that, without showing that any depletion occurred in the year 1926, he was entitled to a depletion deduction from his gross income for that year. The bonuses he received in 1926 constituted income of Petitioner in that year. Burnet v. Harmel, 287 U. S. 103. The burden was on him to show that he was entitled to the deduction claimed. Brown v. Helvering, U. S. Sup. Ct. Jan. 15, 1934. The depletion charge permitted as a deduction from gross income in determining taxable income "in the case of oil and gas wells" represents the reduction, during the taxable year in question, of oil or gas in place in land in which the taxpayer has an interest. Helvering v. Falk, U. S. Sup. Ct. Jan. [fol. 44] 15, 1934; United States v. Luden, 274 U. S. 295, 302. No statutory provision which has come to our notice authorizes such a deduction to be based on an expectation, however well founded, that oil or gas remaining in place in land during the taxable year in question will be extracted in subsequent years. Depletion of oil or gas is a result of the production and sale thereof. Palmer v. Bender, 287 U. S. 551, 558. Instead of the applicable statute specifically allowing, "in the case of oil and gas wells", a depletion deduction from gross income in a taxable year in which no depletion of oil or gas is shown to have occurred, the language of that statute indicates the absence of any intention of the lawmakers to depart from the established rule that a depletion deduction from gross income for a taxable year is allowable only when depletion occurred in that year.

The deduction claimed by Petitioner, not being authorized specifically by the applicable statute or any Regulation thereunder, was properly disallowed. Burnet v. Thompson Oil & G. Co., supra; Brown v. Helvering, supra.

The petition for review is Denied.

Sibley, Circuit Judge, Dissenting:

The question is whether a percentage depletion is allowable on bonuses received in 1926 for oil and gas leases which [fol. 45] are to endure so long as oil or gas is produced when no well was drilled and no oil produced under them during that year, although the oil and gas were present and were produced later. The Board of Tax Appeals denied the allowance because there was no well, and this court denies it

because no oil was taken out. One of the pertinent provisions of the Revenue Act of 1926, "In computing net income there shall be allowed a deduction * * * in the case of mines, oil and gas wells, and other mineral deposits and timber, a reasonable allowance for depletion and for depreciation of improvements according to the peculiar conditions in each case", occurred in previous Acts. The other provision: "In case of oil and gas wells the allowance for depletion shall be 27½ percentum of the gross income from the property during the taxable year", is new. Great difficulty was found under the former provision in estimating the content of an oil and gas reserve under the ground and in arriving at what proportion of it was represented by the operations of a particular taxable year, and also in fixing the value of the reserve under the rules relating to discovery value. To avoid these difficulties Congress in the new provision ignored both the size and the value of the reserve, assumed that the value of any production of oil or gas would on the average be 27½ percent original capital investment not to be taxed, and the remaining 62½ per cent would be taxable income, and provided for its taxation in the year it was received. It is evident that the 27½ percent deduction which the statute not only permits but commands must be made in the year that the income which measures it is received and taxed, that it cannot be taken any subsequent year, and that it is entirely independent of actual depletion, being so named because it looks forward or backward to the exhaustion represented by the income received. The purpose and command of the provision is de-[fol. 46] feated by the decision in this case. The oil and gas were present to be produced, as was of course supposed when nearly a half-million dollars were paid in advance for them as bonuses, and as was proven when the wells were drilled. That the lessees by their own choice not to drill the first year should control the taxability of the lessor's bonuses, or that the depletion allowance on the entire bonuses should depend on the production in the taxable year of a few gallons of oil or a few feet of gas seems to me both unreasonable under the general provision for depletion and in contradiction of the special provision for the percentage deduction.

It is true that depletion, like depreciation because of wear and tear and obsolescence, is based on the actual gradual loss of capital. The allowance for wear and tear

and obsolescence is, however, always estimated and distributed over the useful life of the property considered, and does not depend on a demonstration of what actually happened to it in the particular taxable year. The allowance for them is a general offset against all income for the taxable year rather than a deduction from some particular item of income, because wear and tear and obsolescence, although a loss of capital, do not directly produce any particular income. Depletion also may sometimes be a mere loss, as when oil or gas runs to waste or standing timber dies and rots. But ordinarily depletion refers to a commercial use of part of a reserved store, as where ore or gas or oil is extracted for sale, or timber or ore or oil is manufactured into lumber or metal or gasoline and sold. In such cases the capital represented by the depletion is used directly to produce income and is converted into it. According to Eisner vs. McComber, 252 U. S. 189, only gain is taxable income under the Sixteenth Amendment where a conversion of property is involved. Congress is therefore merely staying on safe constitutional ground in providing for this percentage depletion against income received from [fol. 47] oil and gas. If not a constitutional necessity, it is certainly more reasonable, where income is produced by a commercial depletion, to deduct the depletion from the particular income produced by it as an element of cost rather than to make it an offset against general income in some other year. If for example the owner of timber leases it to a sawmiller to be exhausted over a term of years and is paid as the timber is cut, the actual depletion of his timber by cutting corresponds with his reciept of income and no problem is presented. But if the sawmiller should pay for all after the end of the term, it would be unreasonable to allow the owner depletion in the years the timber was cut when he had no income and no tax to pay, and to tax his whole income without any depletion at the end. So if the whole timber should be paid for in advance. Again, if the timber owner is cutting and selling his own timber, he should be allowed to deduct the value of his timber from the income as received, no matter when the trees were cut or delivered. Although oil and gas are underground and timber is not, both are by the statute depletable and the same principle applies. The bonus on an oil and gas lease is so far as authority can make it merely royalties paid in advance, and both bonus and royalties are the consideration for the oil

expected to be recovered by the lessee. Both are equally income to the lessor from his land, and both are alike subject to be reduced by allowance for depletion. Burnet v. Harmel, 287 U. S. 103; Murphy Oil Co. vs. Burnet, 287 U. S. 299; Bankers Coal Co. vs. Burnet, 287 U. S. 309; Palmer vs. Bender, 287 U. S. 551. The income tax statutes have studiously endeavored to tax net income only, and to make just allowances for expenses and for a return of capital lost in producing it. The statute in question nowhere says that the depletion allowance commanded is to be taken when the oil is extracted, but the general provision has [fol. 48] always been that a reasonable allowance shall be made according to the peculiar conditions of each case. Construing it as to a bonus, it is said in Murphy Oil Co. vs. Burnet, supra, at page 307: "Here an anticipated depletion of capital is to be returned from bonus and future royalties to the extent the applicable statutes allow, and the problem is to allocate such anticipated depletion to a payment made in advance of its occurrence. The alloaction is permitted by statute." This language is quite at variance with that of the court below quoted in the majority opinion. When this provision was first enacted in 1918, Regulation 45, Art. 215 (d), provided that on the expiration or abandonment of a lease without the removal of any or all of the mineral contemplated by the lease, there must be a return to capital account of so much of the bonus deducted from the recoverable capital as exceeds actual depletion, and that amount must be treated as income the year the lease was ended. This shows that it was understood that the bonus payment was considered depletable in advance of actual depletion, and that if the contemplated depletion does not occur the correction is to be made at the end of the lease. The same Regulation has been continued ever since, as Congress has reenacted the same depletion provision, and it is referred to and its operation approved in Murphy Oil Co. vs. Burnet, supra, at page 304, and again at page 306. The statutory words: "In case of oil and gas wells" are directly connected with "or other mineral deposits." Wells as such were not in the mind of Congress as subjects of depletion, but the deposits of oil and gas and other minerals were in mind, and as shown above, depletion of bonuses on leases was regularly allowed although in most cases, no doubt, actual production is not accomplished in the year the lease is made. When in the Act of 1926 Con-

gress again used the expression, "In cas eof oil and gas wells" in connection with the percentage depletion, no nar-
[fol. 49] rower meaning is to be attributed to it. United States vs. Dakota-Montana Oil Co., 288 U. S. 459. On the contrary, even more plainly the receipt of income and not the existence of a well or of production from it is made the generating cause of the depletion allowance. If the tax officer treats a bonus payment as income, he must deplete it 27½ percent under the command of the statute.

In Helvering vs. Falk, — U. S. —, depletion under all the Acts through that of 1926 was under consideration and the cases were reviewed with this conclusion: "Whatever may be said concerning the power of Congress to treat the entire proceeds of a mine as income, obviously the statute has not undertaken to do so. The plain purpose we think was to tax only that portion of the proceeds remaining after proper allowance for depletion. This allowance represents property consumed, is treated as if capital assets, and no tax is laid upon it. The statute must be so applied in practice as to carry out this purpose." The judgment in the case at bar defeats the statutory purpose and by denying the allowance which the statute commands taxes that part of the money received which ought to be treated as if capital assets.

A true copy. Teste:

—— ——, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit.

[fol. 50] No. 7214

WILLIAM E. HERRING

versus

COMMISSIONER OF INTERNAL REVENUE

JUDGMENT

Extract from the Minutes of April 24th, 1934

This cause came on to be heard on the petition of William E. Herring for a review of a decision of the United States Board of Tax Appeals, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court, that said petition be, and the same is hereby, denied.

"Sibley, Circuit Judge, dissenting."

[fol. 57] No. 7214

WILLIAM E. HERRING

versus

COMMISSIONER OF INTERNAL REVENUE

ORDER DENYING REHEARING

Extract from the Minutes of June 8th, 1934

As neither of the judges who concurred in the decision of the court in the above numbered and entitled cause is of opinion that the petition for rehearing should be granted, it is ordered that the said petition be and the same hereby is denied.

[fol. 58] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 7214

WILLIAM E. HERRING, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Motion to Stay Mandate

MOTION AND ORDER STAYING MANDATE—Filed June 14th, 1934

Comes now the above named petitioner and moves that the mandate be stayed pending application for writ of certiorari.

(Signed) Robert Ash, Munsey Bldg., Washington, D. C., Attorney for Petitioner.

[fol. 59] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH DISTRICT

No. 7214

WILLIAM E. HERRING, Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent

On consideration of the application of the Petitioner in the above numbered and entitled cause for a stay of the mandate of this court therein, to enable Petitioner to apply for and to obtain a writ of certiorari from the Supreme Court of the United States, it is ordered that the issue of the mandate of this court in said cause be and the same is stayed for a period of thirty days; the stay to continue in force until the final disposition of the case by the Supreme Court, provided that within thirty days from the date of this order there shall be filed with the clerk of this court the certificate of the clerk of the Supreme Court that the certiorari petition and record have been filed, and that due proof of service of notice thereof under Paragraph 3 of Rule 38 of the Supreme Court has been given. It is further ordered that the clerk shall issue the mandate upon the filing of a copy of an order of the Supreme Court denying the writ, or upon the expiration of thirty days from the date of this order, unless the above-mentioned certificate shall be filed with the clerk of this court within that time.

Done at New Orleans, La., this 14th day of June, 1934.

(Signed) Rufus E. Foster, United States Circuit Judge.

[fol. 60] CLERK'S CERTIFICATE

UNITED STATES OF AMERICA:

UNITED STATES CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT

I, Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit, do hereby certify that the pages numbered from 37 to 59 next preceding this certificate contain full, true and complete copies of all the

pleadings, record entries and proceedings, including the opinion of the United States Circuit Court of Appeals for the Fifth Circuit, in a certain cause in said Court, numbered 7214, wherein William E. Herring is petitioner, and the Commissioner of Internal Revenue is respondent, as full, true and complete as the originals of the same now remain in my office.

I further certify that the pages of the printed record numbered from 1 to 36 are identical with the printed record upon which said cause was heard and decided in the said Circuit Court of Appeals.

In testimony whereof, I hereunto subscribe my name and affix the seal of the said Circuit Court of Appeals, at my office in the City of New Orleans, Louisiana, in the Fifth Circuit, this 15th day of June, A. D. 1934.

Oakley F. Dodd, Clerk of the United States Circuit Court of Appeals, Fifth Circuit. (Seal United States Circuit Court of Appeals, Fifth Circuit.)

[fols. a-1] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

Docket No. 7215

EULA DAY HERRING, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

Stipulation

JOINT STIPULATION AND ORDER TO PRINT THE RECORD IN THE CASE NO. 7214, AND TO OMIT THE PRINTING OF THE RECORD IN CASE NO. 7215, ETC.—Filed November 8, 1933

Whereas the issues in the above entitled cause are precisely the same as the issues in the action entitled William E. Herring v. Commissioner of Internal Revenue, and as the proceedings were consolidated, heard, and disposed of before the United States Board of Tax Appeals on one record, and as the transcript of record on the petitions for review are the same, except as to names, no useful purpose

could be served by hearing the cases separately before this honorable court.

It is therefore stipulated and agreed by and between the parties in the above entitled cause, through their respec-
[fol. 2] tive attorneys, that the printing of the transcript record in this cause may be dispensed with and that the decision of the court in the case of William E. Herring v. Commissioner of Internal Revenue will control and will be accepted by the parties as the decision in the above entitled case.

(Signed) Robert Ash, Attorney for Petitioner.
(Signed) E. Barrett Prettyman, General Counsel, Bureau of Internal Revenue.

[fol. 3] UNITED STATES CIRCUIT COURT OF APPEALS, FIFTH CIRCUIT

No. 7214

WILLIAM E. HERRING, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

No. 7215

EULA DAY HERRING, Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE, Respondent

It is ordered that the record in case No. 7214, William E. Herring, petitioner, vs. Commissioner of Internal Revenue, respondent, be printed, but that the printing of the record in case No. 7215, Eulay Day Herring, petitioner, vs. Commissioner of Internal Revenue, respondent, be omitted; that a like judgment be entered in case No. 7215, Eula Day Herring, petitioner, vs. Commissioner of Internal Revenue, respondent, as in case No. 7214, William E. Herring, petitioner, vs. Commissioner of Internal Revenue, respondent.

(Signed) N. P. Bryan, U. S. Circuit Judge.

November 8, 1933.

[fol. 4] That thereafter the following proceedings were had in said cause in the United States Circuit Court of Appeals for the Fifth Circuit, viz:

No. 7215

EULA DAY HERRING

versus

COMMISSIONER OF INTERNAL REVENUE

ARGUMENT AND SUBMISSION

Extract from the Minutes of March 7th, 1934

On this day this cause was called, and, after argument by Robert Ash, Esq., for petitioner, and Milford S. Zimmerman, Esq., Special Assistant to the Attorney General, for respondent, was submitted to the Court.

[fol. 5] IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

No. 7215

EULA DAY HERRING, Petitioner,

versus

COMMISSIONER OF INTERNAL REVENUE, Respondent

Petition for Review of Decision of U. S. Board of Tax Appeals (District of Texas)

Before Bryan, Sibley, and Walker, Circuit Judges

OPINION OF THE COURT AND DISSENTING SIBLEY, CIRCUIT JUDGE—Filed April 24, 1934

By the COURT:

The parties to the above numbered and entitled cause by written stipulation filed therein having agreed that the decision of this court in the cause, numbered 7214 on the docket of this court, wherein William E. Herring is Pe-

titioner and the Commissioner of Internal Revenue is Respondent, will control and be accepted by the parties to the first above numbered and entitled cause as the decision of this court; and this court having rendered its decision in said cause numbered 7214, wherein William E. Herring [fol. 6] is Petitioner and the Commissioner of Internal Revenue is Respondent, whereby the petition for review therein was denied; it is ordered that the petition for review in the first above mentioned and entitled cause be, and the same is, denied.

Sibley, Circuit Judge, dissenting.

A true copy. Teste.

—— ——, Clerk of the United States Circuit Court of Appeals for the Fifth Circuit.

[fols. 7-10] No. 7215

EULA DAY HERRING

versus

COMMISSIONER OF INTERNAL REVENUE

JUDGMENT

Extract from the Minutes of April 24th, 1934

This cause came on to be heard on the petition of Eula Day Herring for a review of a decision of the United States Board of Tax Appeals, and was argued by counsel;

On consideration whereof, It is now here ordered, adjudged and decreed by this Court, that said petition be, and the same is hereby, denied.

"Sibley, Circuit Judge, dissenting."

[fol. 59] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1934

No. 176

WILLIAM E. HERRING, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

ORDER ALLOWING CERTIORARI—Filed October 8, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 60] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1934

No. 177

EULA DAY HERRING, Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE

ORDER ALLOWING CERTIORARI—Filed October 8, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Fifth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.